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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 002296

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TAGS: [ECON](#) [EIND](#) [EINV](#) [RS](#) [EU](#) [GE](#)
SUBJECT: REGARDLESS OF OPEL DECISION, GM PREPARING TO
EXPAND RUSSIA PRODUCTION

REF: MOSCOW 1617

Classified By: DCM Eric Rubin for reasons 1.4 (b and d)

Summary

1. (C) Despite press histrionics about GM "refusing" to sell to Russians, indications are that -- in one corporate form or another -- GAZ' Nizhny Novgorod plant will start producing GM cars in the next 12-24 months. According to sources at GM CIS, regardless of the GM Board's decision about Opel, GM's strategic planning for Russia remains the same. Either via a successful Magna/Sberbank bid for Opel or the "pre-Opel" negotiated joint venture, a GM platform will be installed in Nizhny for the Russian car market, which is currently predicted to return to pre-crisis levels in 2013.

GM Plans Unaffected By Opel Decision

2. (C) Almost two years ago, GM CIS (in charge of GM sales and production in Russia and the CIS) began negotiating a USD 1 billion joint venture agreement with the GAZ Group to produce GM cars at GAZ' Nizhny Novgorod plant. (Reftel.) In June, when the Magna/Sberbank bid was preliminarily chosen to buy Opel's European operations, GM CIS believed the acquisition would facilitate the rapid conclusion of the GM-GAZ joint venture. Furthermore, with implicit GOR support (Sberbank is a state-owned bank), GM CIS anticipated a degree of GOR protection. The GOR, in turn, publicly hailed the potential purchase of European Opel as a way to gain access to Western technology that would invigorate Russia's auto industry -- at a good price. Since then, the negotiating process has stalled and rumors have begun to circulate that GM now favors the bid from RHJ (an Belgian investment firm), which would allow it to buy back European Opel and that it is opposed to Russian participation in the deal because it is concerned about losing control over GM technology.

3. (C) GM CIS, however, has told us that this is not the case. Even if GM rejects the Magna/Sberbank bid, GM CIS intends to go forward with the joint venture. According to Heidi McCormack (Amcit, please protect), Executive Director of GM CIS, the practical results of either outcome would be substantially similar. In either case, a GM platform would be installed at the Nizhny plant and GAZ would pay royalties to produce GM cars. (Note: we suspect, however, that without Magna/Sberbank participation, GAZ Group's Oleg Deripaska might have more difficulty in sourcing financing, since GAZ

Group is already struggling with USD 1.5 billion debt, owed primarily to Russian government-controlled banks. End note.)

In any case, according to McCormack, the objective would be to turn the Nizhny plant into a domestic producer of GM cars for what was, until the crisis hit, a vibrantly expanding market.

Bruised Russian Egos And Possible Short Term Setback

14. (C) McCormack noted that GM's rejection of the Magna/Sberbank bid for Opel might bruise Russian egos and delay getting the joint venture back on track for two to four months. However, since current predictions by Ford and GM were that the Russian car market would not recover to its pre-crisis levels until 2013, there was time to spare.

15. (C) Other observers were equally phlegmatic about a possible GM rejection of the Magna/Sberbank deal. The German Economic Counselor told us that, Chancellor Merkel's statements notwithstanding, the German government (and particularly the Embassy) was not "overly engaged" in lobbying for the Magna/Sberbank bid. Troika Dialog auto sector analyst Mikhail Ganelin told us that, given crashing Russian demand (July car sales were down 58 percent y-o-y), GAZ' acquisition of European Opel would not enhance the sector significantly. He noted that while the Opel line would possibly make GAZ more competitive over time, GAZ's competitive advantage remained in production of light, inexpensive commercial vehicles, not passenger cars. Ganelin suggested that GAZ devote its energies to improving

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its traditional product line to help it pay back its debt. (Note: Ganelin was not aware of the GM CIS-GAZ Group joint venture as that information has not been made public. End note.)

Technology Transfer Will Not Occur

16. (C) Much of the press speculation covering GM's doubts about Russia as a partner have highlighted intellectual property protection concerns. McCormack conceded that communication with the Russian side on technology transfer remained tense. She explained that while GAZ Group, either as Magna/Sberbank's industrial partner or GM's joint venture partner, had the right to use technology via royalty payments -- just like every other global GM manufacturer -- GAZ could not buy GM's technology. "It is not for sale," McCormack stated. Therefore, she added, whatever form the deal took, there would not be wholesale technology transfer to resuscitate Russia's car industry "writ large". She concluded that until Russian car manufacturers could display the requisite planning skills and tenacity to develop their automotive industry by training engineers and managers over the long term, it was not possible simply to "leapfrog into a technologically advanced state".

Comment

17. (C) Whatever decision is made on Opel's European division, GAZ will likely be producing GM cars from an existing GM manufacturing platform. Assuming an eventual rebound in the domestic demand for cars, GAZ-produced GM's are likely to be competitive as they have the advantage of being a Western-designed car without the expense of import tariffs. Such a rebound, however, does not appear imminent, and it will be several years before there is significant demand to justify increased production. End Comment.
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